FARMERMAC
Financing Rural America

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Via Electronic Mail to reg-comm@fca.gov
Laurie A. Rea
Director, Office of Secondary Market Oversight
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: Notice of Proposed Rulemaking: "Federal Agricultural Mortgage Corporation Funding and Fiscal Affairs; Farmer Mac Investments and Liquidity Management"
12 CFR Part 652, RIN 3052-AC56, November 18, 2011

Dear Ms. Rea:

The Federal Agricultural Mortgage Corporation ("Farmer Mac") appreciates the opportunity to provide additional comments for your consideration regarding the above-referenced proposed rule (the "Proposed Rule")[1] published by the Farm Credit Administration ("FCA") relating to the liquidity regulations applicable to Farmer Mac.[2] As mentioned in Farmer Mac's letter to FCA dated April 17, 2013, Farmer Mac has had an opportunity in light of FCA's final rules on investment management to evaluate the effects that the Proposed Rule, if enacted,[3] would have on Farmer Mac's operations. In this context, Farmer Mac requests that FCA consider the following additional points prior to issuing any final rule on Farmer Mac's liquidity requirements.

[1] 76 Fed. Reg. 71798 (Nov. 18, 2011).

[2] The first phase of final regulations from the Proposed Rule, relating to investments management, is set forth at 77 Fed. Reg. 66,375 (Nov. 5, 2012).

[3] For purposes of this letter, Farmer Mac has assumed that the investment categories for liquidity in the final rule would be conceptually consistent with the recently finalized liquidity rule for Farm Credit System institutions, which has Level 1, Level 2, and Level 3 liquidity levels, rather than the Proposed Rule as published in the Federal Register, which proposed Level 1, Level 2, and Supplemental Liquidity levels. *See* Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Liquidity and Funding; Final Rule, 78 Fed. Reg. 23,438 (2013) (to be codified at 12 C.F.R. pt. 615).

USDA Guaranteed Portions

Under the Proposed Rule, guaranteed portions of loans guaranteed by the U.S. Department of Agriculture ("USDA-guaranteed portions") that Farmer Mac owns and that currently count toward Farmer Mac's days-of-liquidity requirement would not be included as an eligible asset to satisfy Farmer Mac's days-of-liquidity requirement.[4] Farmer Mac respectfully requests that FCA consider including these USDA-guaranteed portions as eligible investments for any final rule, consistent with current regulation.

USDA-guaranteed portions serve a uniquely important role in Farmer Mac's portfolio. Not only do these investments further Farmer Mac's Congressionally mandated mission to provide credit and liquidity to rural America, but they also are of the highest credit quality assets[5] and very liquid,[6] with an active and established secondary market. Farmer Mac's USDA-guaranteed portions provide a strong and natural base of balance sheet liquidity that is entirely consistent with the credit quality and liquidity characteristics of Level 2 and Level 3 assets contemplated by the Proposed Rule. These investments also support other mission-related activity, including purchases of AgVantage® securities, a cornerstone of Farmer Mac's program portfolio and an important source of credit and liquidity to lenders serving rural borrowers. AgVantage® securities typically have large principal balances that are repaid in their entirety at maturity, thereby regularly requiring a large pool of liquid assets to effectively manage Farmer Mac's liquidity requirements. Including USDA-guaranteed portions historically as a component of Farmer Mac's liquidity management approach has helped enable Farmer Mac to provide its AgVantage® products to lenders.

Presently, USDA-guaranteed portions contribute approximately $1.0 billion in liquidity to Farmer Mac.[7] Excluding these assets as a source of primary liquidity in any final rule would

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[4] Under the Proposed Rule, USDA-guaranteed portions would only be included for purposes of supplemental liquidity, but would not count toward the 90 days of Level 1, Level 2, and Level 3 investments that would be required.

[5] The USDA-guaranteed portions that Farmer Mac is authorized to purchase under its Congressional charter are limited to the portions that are fully guaranteed by the U.S. Department of Agriculture and backed by the full faith and credit of the United States government.

[6] The trading market for USDA-guaranteed portions and whole loans is very liquid with many broker-dealers and banking institutions as participants. Bid-ask spreads for these assets typically do not widen beyond 3/8 of a percentage point, and during the height of the financial crisis in 2008 did not widen to more than 1 to 2 percentage points. Farmer Mac is confident that the market for USDA-guaranteed portions is sufficiently large that it could absorb all of Farmer Mac's USDA-guaranteed portions within 30 days. This fact was demonstrated during the financial crisis when Farmer Mac was able to line up multiple bidders for its USDA-guaranteed portions, reflecting the demand for these high-quality assets.

[7] This amount represents $1.4 billion of USDA-guaranteed portions as of March 31, 2013, including a 25 percent discount under current regulation and excludes $250 million that would be applied to satisfy claims of Farmer Mac II LLC's preferred stockholders in liquidation.

require Farmer Mac to dramatically upsize its investment portfolio to meet its liquidity requirements under the Proposed Rule. Under many circumstances, this would force Farmer Mac to exceed its non-program portfolio size limitation of 35 percent of program assets and obligations, as specified in the recently promulgated investment management rule.[8] The withdrawal of eligibility for USDA-guaranteed portions, which as program assets would not count toward the 35 percent limit for non-program investments, would require Farmer Mac to replace the liquidity otherwise provided by the USDA-guaranteed portions with a similar sized pool of eligible investment assets that *would* count toward the 35 percent limit. The potential disqualification of USDA-guaranteed portions as an eligible liquidity source[9] would have required Farmer Mac to increase the size of its eligible investment portfolio by $800 million to $1.1 billion.[10]

Initial analysis indicates that without including USDA-guaranteed portions, Farmer Mac would be required to hold between $4.0 and $4.8 billion of investment securities to meet its liquidity requirement over the next year, and that for most of that period, this volume of required investment securities would exceed the 35 percent limit for non-program investments. As a result, Farmer Mac would regularly need to seek exemptive relief either from its liquidity requirements[11] or from the 35 percent non-program asset limit.[12] This could also have longer-term implications for Farmer Mac's mission-related activities, as Farmer Mac would have to re-evaluate whether it could continue to offer the wide variety of financing tools it has traditionally offered, including AgVantage securities, which could be much riskier from a liquidity management perspective.

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[8] 12 C.F.R. § 652.15(b). This is further exacerbated by the fact that the 35 percent limit applies to Farmer Mac's program assets and obligations <u>excluding</u> 75 percent of Farmer Mac's USDA-guaranteed portions.

[9] This factor would be exacerbated by the disqualification of additional classes of assets that Farmer Mac may currently count toward its liquidity requirement but would not be allowed (other than as supplemental liquidity instruments) under the Proposed Rule, such as non-agency mortgage-backed securities, asset-backed securities, and corporate debt.

[10] These amounts are based on 2012 monthly Farmer Mac data and represent the average-to-peak range of incremental liquidity investments that would be needed for Farmer Mac to meet its liquidity requirements under the Proposed Rule with a target liquidity goal of approximately 100 days and to account for volatility of liquidity needs throughout the year.

[11] *See* 12 C.F.R. § 652.45 (providing a mechanism under which FCA could grant relief from its liquidity and investment regulation requirements).

[12] Farmer Mac estimates that if the Proposed Rule had been in effect during 2012, Farmer Mac would have needed to seek a waiver from either its liquidity requirement or its 35 percent limit for approximately nine out of the twelve months of the year. As a reporting company under the Securities Exchange Act of 1934, Farmer Mac would be required to disclose any such waivers in its quarterly and annual periodic reports filed with the Securities and Exchange Commission.

Farmer Mac believes that a more prudent approach would be to continue to include USDA-guaranteed portions – investments that are both safe and liquid – as investments counted toward Farmer Mac's days-of-liquidity requirement. The market for USDA-guaranteed portions is liquid with many broker-dealer and banking institutions participating. The typical bid-ask spread for these securities is up to 3/8 of a percentage point. This liquidity is driven by the high credit quality of these securities, the residual risk-sharing portion retained by the seller of the USDA-guaranteed portion, and the zero percent risk weighting for many banking institutions, credit unions, and insurance companies. As such, Farmer Mac believes it is essential to continue including them as sources of liquidity for regulatory purposes.

If FCA's final rule includes USDA-guaranteed portions for purposes of Farmer Mac's liquidity requirement, as requested in this letter, Farmer Mac also respectfully requests that FCA consider USDA-guaranteed portions as Level 3 instruments for purposes of Farmer Mac's liquidity requirement and apply haircuts consistent with Level 3 investments or investments held for supplemental liquidity (as those instruments have been defined in the final regulation for Farm Credit Systems Banks and Associations).[13] Because Farmer Mac can generate liquidity through securitization as well as through sale, a lower haircut than the current 25% haircut would be in line with the actual liquidity of these instruments.

Implementation Timing

Farmer Mac also respectfully requests that in connection with any final rule, FCA consider implementing a phasing in of the liquidity requirements over a 6-month period after the rule is published. In order to meet the liquidity requirements described in the Proposed Rule, Farmer Mac may need to hold a larger amount of liquidity portfolio investments than it has historically held. Consistent with Farmer Mac's current approach to liquidity management, Farmer Mac would seek to obtain the most liquid investments of varying maturities and not sacrifice long-term stability merely to satisfy the immediacy of a new regulation. Rather, it is in Farmer Mac's interest, from a liquidity standpoint as well as a safety and soundness standpoint, to be deliberate about its purchases so that it is consistently able to meet liquidity requirements under any final rule.

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[13] *See, e.g.*, 12 C.F.R. § 615.5134 (April 18, 2013).

Farmer Mac thanks FCA for the opportunity to comment and appreciates its consideration of these comments. We would be pleased to discuss these matters further at your request.

Very truly yours,

Timothy L. Buzby
President and Chief Executive Officer